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April 15, 2004

Thomas M. Dorman
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
Frankfort, Kentucky 40601

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RE: Application of Louisville Gas and Electric Company for an Adjustment of its Gas and Electric Rates, Terms and Conditions
Case No. 2003-00433

Dear Mr. Dorman:

Enclosed please find and accept for filing the original and ten copies of Louisville Gas and Electric Company's supplemental response to Commission Staff's Third Data Request Dated March 1, 2004, Item No. 9(b) in the above-referenced matter. Subsequent to the filing of LG&E's initial response, the FERC issued the attached Reply regarding "Recognition of Regulatory Asset for Minimum Pension Liability." Please confirm your receipt of this filing by placing the stamp of your Office with the date received on the enclosed additional copy.

Should you have any questions or need any additional information, please contact me at your convenience.

Very truly yours,

Kent W. Blake
Director, Regulatory Initiatives

Enclosures

cc: Parties of Record

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In Reply Refer To:

OED-DRAP

Docket No. AI04-2-000

March 29, 2004

106 FERC ¶ 62,230

Recognition of a Regulatory Asset for Minimum Pension Liability

TO ALL JURISDICTIONAL PUBLIC UTILITIES AND LICENSEES, NATURAL
GAS COMPANIES, AND OIL PIPELINE COMPANIES

The generally lower interest rate environment of recent years and decline in value of assets set aside to meet pension obligations has resulted in many FERC jurisdictional entities recognizing a minimum liability for employee pension obligations. The Commission has received a number of requests for guidance on whether a regulatory asset should be recognized for some or all of the charge to other comprehensive income that is made at the time the minimum pension obligation is recognized. The following discussion responds to these requests.

Facts: An entity provides pension benefits to its employees under a defined pension benefit plan and recognizes pension expense (i.e. net periodic pension cost) for financial accounting and reporting purposes in accordance with Statement of Financial Accounting Standards No 87. (SFAS No. 87).¹ The rates the entity charges for services provided by a segment of its business are regulated by a third party regulator and are determined on the basis of the entity's costs. Development of the rates to be charged for services provided by this business segment include an allowance for employee pension benefits and the amount of that allowance is based on net periodic pension cost determined in accordance with SFAS No. 87. As a result of a decline in the value of its pension fund assets and an increase in the accumulated pension benefit obligation due to lower interest rates used to estimate that obligation on a present value basis, the entity determines that its accumulated pension benefit obligation exceeds the fair value of the assets set aside to meet that obligation. Consistent with the requirements of SFAS No. 87, the entity records a minimum pension liability for the amount of such excess.

¹ Financial Accounting Standards Board Statement of Financial Accounting Standards No 87, Employer's Accounting for Pensions

Question: At the time the entity recognizes its minimum pension liability in accordance with SFAS No. 87, should it recognize a regulatory asset for the amount of the liability otherwise chargeable to accumulated other comprehensive income that relates to its cost based rate-regulated business segment?

Response: The cost of pension benefits provided to employees under a defined pension benefit plan are recognized as an expense at the time the employee provides related employment services. SFAS No. 87 contains a delayed recognition feature. This means that changes in the pension obligation and the value of assets set aside to meet these obligations are not recognized when they occur but are recognized systematically and gradually over subsequent periods.² An entity that determines its pension allowance included in its costs based regulated rates on the basis of SFAS No. 87 adopts that same delayed recognition feature for ratemaking purposes. That is, changes in the pension obligation and assets set aside to meet those obligations are not included in rates when they occur but rather are included in rates systematically and gradually in subsequent periods. The recognition of a minimum pension liability which would otherwise be charged to accumulate other comprehensive income therefore constitutes a measurement of the changes in pension obligations and the value of plan assets that are to be included in the determination of rates in subsequent periods in so far as they relate to the cost based rate regulated segment of the entity.

Under the Commission's accounting requirements regulatory assets are to be established for those charges that would have been included in net income or accumulated other comprehensive income determinations in the current period under the general requirements of the Uniform System of Accounts but for it being probable that such items will be included in a different period(s) for purposes of developing rates that the utility is authorized to charge for its utility services.

Therefore, in the circumstances described above and provided that it is probable that the pension allowance to be included in rates in future periods will continue to be calculated on the basis of SFAS No. 87, entities shall recognize a regulatory asset for the minimum pension liability otherwise chargeable to accumulated other comprehensive income related to its cost based rate regulated business segments.

² Ibid. (See: Summary - Fundamentals of Pension Accounting)

Further, the minimum pension liability, as well as, any related regulatory asset is not amortized over future periods. At each measurement date, the entry recorded for the previous measurement date is reversed and the computation redone. A new minimum liability and related regulatory asset would be recognized, if required, at the new measurement date.

This guidance is for accounting purposes only and does not limit the Commission from reviewing the reasonableness of the elements of pension expense included in future rate proceedings before the Commission.

John M. Delaware
Deputy Executive Director
And Chief Accountant